



MEDIA ADVISORY

CALIFORNIA STATE TREASURER PHIL ANGELIDES

FOR IMMEDIATE RELEASE
April 28, 2005

CONTACT: Dan Newman
(916) 653-4052

FOR TODAY, THURSDAY, APRIL 28

**CALIFORNIA TREASURER PHIL ANGELIDES TO DISCUSS
NEW REPORT ON CALIFORNIA EARTHQUAKE AUTHORITY (CEA),
AND PUSH FOR CHANGES TO STRENGTHEN THE CEA**

SACRAMENTO, CA – At today's meeting of the California Earthquake Authority (CEA), State Treasurer Phil Angelides will discuss the findings of a new report issued by the CEA on challenges facing the Authority and will urge the CEA Board to sponsor legislation to strengthen the financial integrity of the Authority, and to protect policyholders. Today, Angelides sent the attached letter regarding this matter to his colleagues on the Board.

Under current law, insurers provide a \$2.2 billion funding commitment that is an integral component of the CEA's fiscal stability. This commitment is scheduled to expire on December 1, 2008.

The analysis, requested by Angelides, details potential impacts of the loss of the insurers' commitment, including the risk that the CEA's credit rating will fall to junk bond status; that the CEA's ability to survive over the long-term will significantly diminish; and that earthquake insurance premiums will increase substantially.

The California Earthquake Authority was established following the 1994 Northridge earthquake. California's Governor, Treasurer, and Insurance Commissioner sit as the voting members of the CEA Board. The Assembly Speaker and the Chairperson of the Senate Rules Committee are non-voting, ex-officio members of the Board.

WHO: California State Treasurer Phil Angelides at the meeting of the California Earthquake Authority.

WHAT: Treasurer Angelides will discuss a new report detailing challenges to the CEA, and propose solutions to strengthen the Authority.

WHEN: Thursday, April 28, 2005
1:00 pm

WHERE: California Earthquake Authority Board Meeting
State Capitol
Room 447

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PHILIP ANGELIDES
Treasurer
State of California

April 28, 2005

The Honorable Arnold Schwarzenegger

The Honorable John Garamendi

The Honorable Don Perata

The Honorable Fabian Núñez

Last December, because of my ongoing concerns regarding the long-term financial strength of the California Earthquake Authority (CEA), I requested an analysis of the potential impacts of the expiration of the "1st Industry Assessment Layer" (1st IAL) set to occur December 1, 2008. (See Attachment A.) This analysis is before us today for our consideration as a Board.

As we all know, California home and business owners are susceptible to catastrophic losses caused by earthquakes. Following the Northridge earthquake in 1994, which resulted in insured losses of nearly \$13 billion, Governor Wilson and the Legislature enacted legislation creating the California Earthquake Authority (CEA) with the mission to make earthquake insurance affordable and broadly available to Californians to protect them from catastrophic losses. Prior to the enactment of this legislation, any insurance company that offered homeowners insurance in California was required to also offer earthquake insurance. This legislation provided that, in lieu of offering earthquake insurance, any insurance company offering homeowners insurance could fulfill their obligations with respect to earthquake insurance by joining the CEA.

As you are well aware, in the event of an earthquake, the CEA fulfills its commitments to policyholders from several major sources of funding, or "layers," in the following order. The first source of funding to meet claims is the CEA's own capital, currently at approximately \$1.8 billion. Once the CEA's capital is drawn down, the participating members of the insurance industry are required to pay the next \$2.2 billion in claims (1st IAL). Collateralized re-insurance contracts, other forms of re-insurance and a second insurance industry assessment make up the remainder of the CEA's claims paying capacity. I have long been concerned that when the 1st

IAL disappears, it may have a detrimental effect on the CEA's survivability (its ability to meet its claims and continue to operate over time), its credit rating, its ability to fully pay claims to policyholders, and the premium costs paid by homeowners.

The 1st IAL provides a critically important piece of the CEA's financial strength and its ability to keep premiums and deductibles affordable for policyholders. The analysis before us raises a number of significant issues arising from the expiration of the 1st IAL on December 1, 2008, including the following:

- **Junk Bond Status:** The CEA currently enjoys an A- financial strength rating from A.M. Best, an insurance rating agency. With the loss of the 1st IAL, the CEA estimates that its financial strength rating could fall below B+, which would be junk bond status. This lower financial strength rating would increase the costs of reinsurance and the CEA's costs to purchase other financial instruments. These increased costs would also result in higher insurance rates for policyholders. I am deeply concerned that an entity created by the State and that is an integral part of the State could be assigned a junk bond rating.
- **Increased Risk to the CEA's Survivability:** The CEA analysis highlights the precipitous drop in the projected survivability of the CEA over the period 2006–2025 from 75 percent to 59 percent. (See Attachment B.)
- **Higher Premiums:** The CEA analysis projects premium increases to policyholders of nearly 20 percent, making coverage significantly less affordable to California consumers, particularly those like our senior citizens and those living on fixed incomes. (See Attachment C.) In fact, consumers will be paying more for less – premiums will increase while the CEA's survivability declines.
- **Inability to Handle Major Earthquake:** The loss of the 1st IAL would reduce the CEA's total funding capacity from approximately \$8.2 billion to \$6.1 billion in 2010. Currently the CEA is positioned to withstand a major earthquake or series of earthquakes that are equal to or greater than a 1 in 1000-year event(s). By 2010, without the first IAL, the CEA will be able to handle an earthquake or earthquakes of no greater than a 1 in 375-year event(s).

It is essential that the CEA remain financially viable so that it can meet its obligations to policyholders in the event of earthquakes and so that it can continue to provide this important protection at reasonable prices for Californians. It is therefore critically important that the Governor and the Legislature take any and all actions necessary to ensure the continued viability of the CEA, and the continued availability of affordable earthquake insurance for California homeowners.

Based on this analysis, I believe strongly that the CEA Board must sponsor legislation to strengthen the financial integrity of the CEA, and to protect policyholders, including consideration of extending the obligation of insurers to fund the 1st IAL past its current expiration date of December 1, 2008.

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I look forward to our consideration of this matter and I thank the CEA staff for their thorough and timely analysis.

Sincerely,

A handwritten signature in blue ink, appearing to be 'Phil Angelides', is written over a light blue rectangular background.

Phil Angelides
State Treasurer

cc: J. Clark Kelso, Designee of the Governor
Bruce Patton, Designee of the Insurance Commissioner
J. Deitrich Stroeh, Designee of the Senate Rules Committee
Pedro Reyes, Designee of the Speaker of the Assembly
Elaine Bush, Chief Executive Officer, California Earthquake Authority



PHILIP ANGELIDES
Treasurer
State of California

December 23, 2004

Elaine Bush, Chief Executive Officer
California Earthquake Authority
801 K Street, Suite 1000
Sacramento, CA 95814

Dear Ms. Bush:

As you know, the California Earthquake Authority (CEA) was created in 1996 to address the availability of homeowner's and earthquake insurance following the Northridge earthquake. Governor Wilson and the Legislature formed the CEA to make earthquake insurance affordable and broadly available to Californians. It is critical that the CEA remain financially viable so that it can meet its obligations to policyholders in the event of earthquakes and so that it can continue to provide this important protection for Californians.

In that vein, I am writing to urge the CEA to take steps now to assure that it is able to continue to fulfill its mission over the long term. Specifically, I believe the CEA should complete an analysis of the potential impacts that the expiration of the "1st Industry Assessment Layer" (1st IAL), set to occur December 1, 2008, will have on the financial viability of the CEA, on its ability to meet its obligation to its policyholders, and on consumers.

The 1st IAL -- a \$2.2 billion funding commitment by insurers which was an elemental part of the agreement that led to the creation of the CEA -- provides an important piece of CEA's financial strength and its ability to meet its obligations to homeowners in the event of earthquakes and to keep premiums and deductibles affordable for policyholders. I am concerned that when the 1st IAL disappears, it may have a significant effect on, among other things, the CEA's claims paying capacity, the prices paid for reinsurance, and premium costs to homeowners.

It is important that this analysis use reasonable and prudent assumptions, given the importance of CEA's coverage to over 730,000 policyholders. For example, it is my understanding from CEA staff that although total current funding and claims paying capacity has increased substantially over the past three years to a total of \$6.8 billion, much of this increase was due to an increase in the number of premiums sold and significant reductions in reinsurance fees and cost. This likely

Elaine Bush
December 23, 2004
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may not continue past 2008, especially in light of the leveling off of homeowner policies and potential increases in reinsurance costs.

I request that a full analysis be brought back to the Board no later than the April 2005 Board meeting, so that the Board and the public will be able to understand and evaluate the impacts arising from the expiration of the 1st IAL. It is also important that this report be completed so that Governor Schwarzenegger and the Legislature can consider any actions which may be necessary to ensure the continued viability of the CEA, and continued availability of affordable earthquake insurance for California homeowners.

I look forward to the receipt of this report to address the long term funding capacity and sustainability of the CEA. If you would like to discuss this matter, please call Ted Eliopoulos, Deputy Treasurer at 916-657-3218.

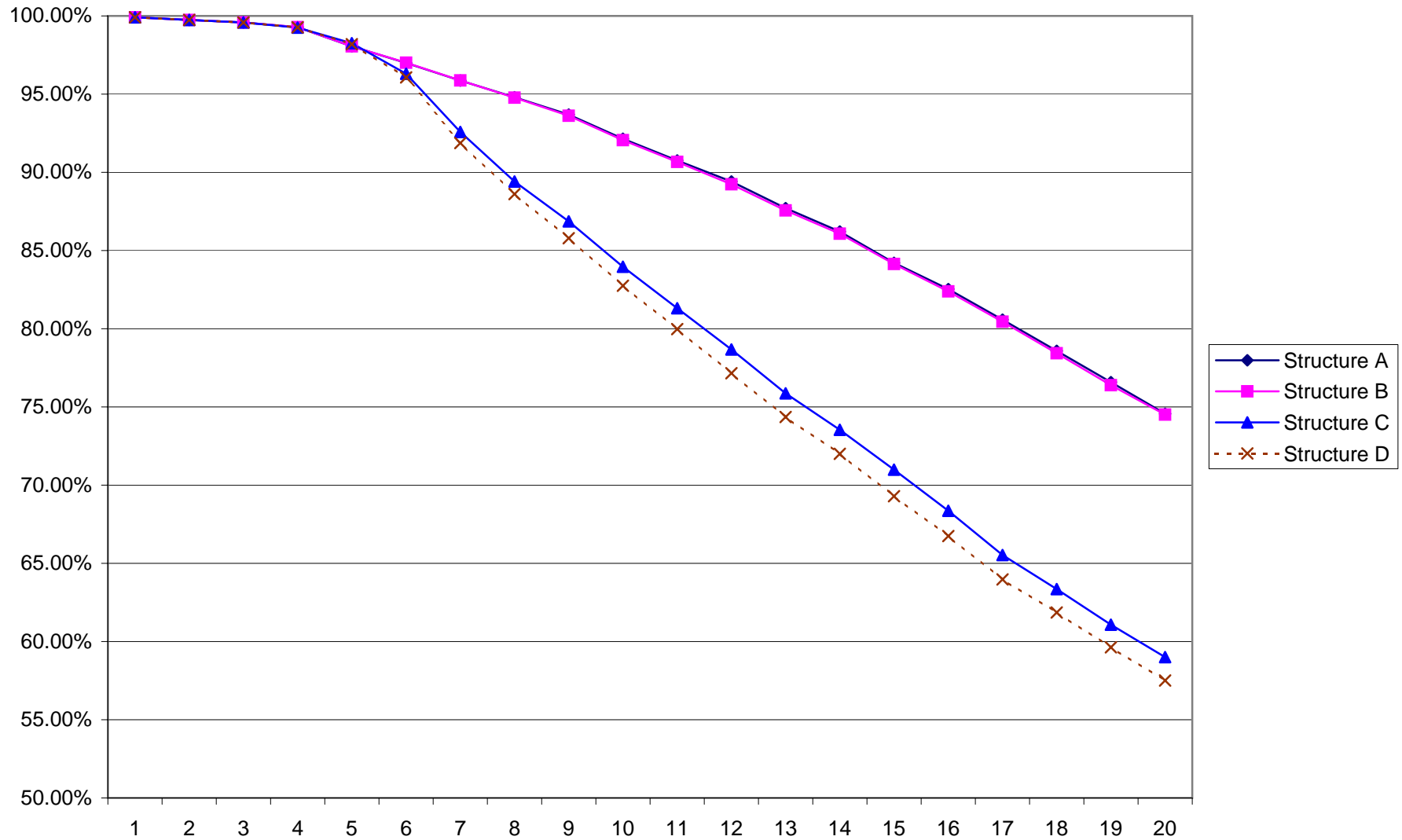
Sincerely,



Phil Angelides
State Treasurer

cc: Honorable Arnold Schwarzenegger
Honorable John Garamendi
Honorable Fabian Nunez
Honorable Don Perata
J. Clark Kelso, Chairperson, California Earthquake Authority
Bruce Patten, Department of Insurance
J. Deitrich Stroeh, Designee of the Senate Rules Committee
Pedro Reyes, Designee of the Speaker of the Assembly

Cumulative Survival



Avg. Cost to Policyholder

